THE NATIONAL CITY BANK OF NEW YORK

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Economic Conditions
Governmental Finance
United States Securities

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General Business Conditions

THE opinion generally expressed at the year-end, that the trend of business during the first quarter or half of 1934 would be upward, has been strengthened during the past month. More active buying in commodities, merchandise and securities, at advancing prices, gives evidence of a rising spirit of optimism. Wholesale trade particularly has increased, with the number of buyers in the chief centers the largest at this season in several years; and this buying reflects the judgment of merchants as to the state of purchasing power and trade prospects in their territories, and as to price trends generally. Likewise it shows that inventories accumulated last Summer have been satisfactorily reduced.

The results of January retail clearance sales are almost everywhere described as good, with less necessity than usual for sharp price cuts to liquidate merchandise. In the first half of the month New York City department store sales were 9.1 per cent better than a year ago, in dollars, which compares with a gain of 5.4 per cent in December. Mail order and chain store sales have shown very satisfactory increases over 1933, according to preliminary reports.

As a rule January is not expected to produce much encouraging business news, since seasonal influences are not favorable to expansion until Spring; and in fact there have been fewer gains in productive activity during the month than had been hoped for. However, the factor of outstanding importance in the trade outlook at present is outside the normal range of business news. It is to be found in the disbursement of Government funds, which is proceeding at a rate never equalled except at the war-time peak. The deficit of expenditures over receipts of the Federal Treasury in the first twenty-six days of the month was $682,000,000. These expenditures, going in part directly to individuals through the Civil Works and Agricultural Adjustment Administrations, and also indirectly through many other channels, are distributing purchasing power widely. Moreover, the budget message has put the country upon notice that in the second half of the fiscal year, ending June 30, it is intended to incur a deficit nearly six times as large as that of the first half, ended last December.

Moody's Investors' Service has made a classification of the distribution of the proposed disbursements in the current fiscal year, showing that $1,883,000,000, of which $500,000,000 has already been paid, will go to farmers in loans and benefit payments; $1,229,000,000 for building; $1,205,000,000 in direct relief, including the C. W. A. and conservation work; and $457,000,000 to mortgage institutions and home-owners. As these sums reach consumers, and are spent in trade, they start a flow of buying power around the circle. Likewise, the Government funds used to free closed bank deposits and to add to the banking capital represent large present and future additions to purchasing power.

Of course, the effect of public expenditures upon trade can only be in the nature of a temporary stimulus or stopgap. When the time comes, as it must, to discontinue them, the trade situation will depend once more upon the purchasing power created by the production and exchange of goods; and the important question then will be whether sound economic adjustments have been made, and price relationships that will promote production and exchange restored. But while they last the expenditures will help to make up for the deficiency in natural buying power, and will give effective support to trade.

Money and Price Relationships

Probably the new monetary measures, which are discussed subsequently in this Letter, have also had a stimulating effect on prices, although the connection is chiefly one of sentiment. Business men generally recognize that the revaluation of the monetary gold will add enormously to the credit base, and the possibilities in the way of potential credit

expansion may have led to forward buying in some measure. The movement of funds into this country from abroad, as indicated in the foreign exchanges, evidently has been encouraged by setting the limits within which it is expected ultimately to revalue the dollar, and these incoming funds help prices in the markets in which they are invested. They have been a factor in the rise in stocks and bonds.

Another reason for hopeful business sentiment is that the rise in commodity prices has been chiefly in the farm group, where it was most needed. On the increased buying of cotton goods, and expectations that the crop will be sharply reduced, cotton prices again approached the highs of last Summer. Wheat prices have firmed with flour business better, eggs have shown strength in contrast to the usual seasonal weakness, and butter has recovered from the extreme lows of December. Livestock prices are moderately higher. The Bureau of Labor's latest index of farm prices, 59.0 per cent of the 1926 average on January 20, was 4.2 points higher than a month earlier, and 16.0 above a year ago. These changes are in the right direction, tending to restore the ratio of farm prices to other prices, and hence to facilitate trade between farm and industry.

To be sure, most business men recognize that the situation, even in respect to the stimulating influences mentioned, is not unqualifiedly favorable. They realize that the dependence upon Government funds as a source of purchasing power will impose a time limit upon the recovery, unless the kind of purchasing power that comes from sound and equitable relationships within the economic system is built up before the expenditures end. They know that by all past standards farm prices and wages of farm labor are still distressingly low in relation to prices the farmer has to pay, and that the improvement which has occurred has been largely brought about by measures whose experimental nature is freely admitted.

Such considerations as these keep trade expectations within conservative limits, but it is plainly the general opinion that the balance is on the side of improvement.

Industrial Pickup Slow

In industrial operations the pickup expected after the holidays has been slow, and in the early part of the month the indexes of general production and distribution showed little or no improvement over December, after allowance for seasonal influences in the comparison. Production difficulties with new automobile models in part supply the explanation. The automobile industry, together with construction, is usually the leader of business in the first quarter, supporting expansion in other industries by its purchases. This year the model changes have been difficult, January output has fallen substantially below estimates, and buying from other industries has been delayed. All this is obviously temporary. No loss of business to the industry as a whole is involved, since the bulk of Spring sales comes after March 1; and January's lost production will doubtless appear in the February and March figures. The interest in the shows has been heartening, paid attendance having been larger by a good margin than in any year since 1929.

A fair decline in steel operations during the month would not have been surprising, since the December output admittedly supplied some January needs. However, according to weekly estimates production has approximately equalled the December rate of 33½ per cent of capacity, and scrap markets have been advancing for two months. New business has hardly reached expectations, rail and structural steel purchases having lagged as well as automobile buying. It is likely that prospective rail purchases were over-estimated, according to Iron Age.

As concerns building, however, the rate at which contracts are now being awarded should inspire the steel makers with optimism. The Dodge figures of awards in thirty-seven states during the first three weeks of January, on a daily average basis, were a shade less than in December, but 144.1 per cent above January, 1933. The greatest increase was in public works and utilities, up 199.0 per cent, but non-residential and residential contracts were 109.7 and 30.5 per cent larger, respectively.

Increasing sales of textiles have checked the declining trend of production in various divisions of the industry, notably cotton and silk. In December cotton mill operations dropped below a year previous by a considerable margin, but new orders in January have given many mills enough business to last them into March, and operations are being stepped up. Except in certain divisions the uniform restriction of hours below the code maximum, put into effect some weeks ago, has been abandoned, and this is true in the hosiery and silk goods industries also. Woolen markets have been less active, but mills still have orders to go on and expect a revival of buying in February.

Improvement in Earnings

Earnings reports of corporations for 1933 thus far published indicate in most cases a marked improvement over 1932. A preliminary tabulation of some 350 industrial companies, engaged in various lines of manufacturing and trade and having an aggregate net worth of $6,534,000,000, shows combined net profits, less deficits, of approximately $163,000,000 in 1933

as compared with a deficit of $41,000,000 in 1932 for the same companies. The 1933 profits represented an average rate of return upon net worth of 2.5 per cent. The proportion of concerns operating at a profit rose from 43 per cent of the total in 1932 to 62 per cent in 1933. Many representative companies went into the black last year for the first time since 1929 or before, while many others still operating in the red reduced the amount of their deficit.

Judging from the early reports, the industries that enjoyed the best earnings last year were those engaged in producing articles for immediate consumption, including cotton goods and other textiles, shoes, meat packing and miscellaneous food products, also automobiles, paper and petroleum. Results in wholesale and retail trade were better. The heavy industries, such as steel, building materials, electrical and other machinery, railway equipment, etc., continue to lag; nevertheless many companies have shown some improvement, either by cutting their losses or by turning in small profits. An important factor in the gains last year was the rise that occurred in commodity prices, contrasting with the decline during 1929-1932 which necessitated heavy writing down of inventory valuations. The downward readjustment in capitalization and in fixed assets by many companies has enabled them to reduce operating and overhead charges sufficiently to show a profit on a much smaller volume of business than formerly.

It is planned to present in our March issue a more detailed discussion of business profits, together with a table summarizing by major industrial groups the rate of profits return upon net worth of the much larger number of corporations whose reports will then be available.

A Hopeful Outlook for Cuba

The Cuban situation has taken a sudden and most gratifying turn for the better, by the accession of Dr. Carlos Mendieta to the presidency of the provisional government, with the support of representative groups apparently strong enough to accomplish the restoration of order and constitutional government. He is a man of strong personality, high intelligence and character, himself representative of the best type of Cubans. His devotion to Cuba cannot be questioned, but it will not take the mistaken form of antagonism to the legitimate business activities and interests of foreigners in the island. Among the purposes which he has publicly disclosed in taking office is that of "strengthening the relations with our great northern neighbor and best customer," which he made more emphatic by adding that "the future of Cuba lies in her going hand in hand with the United States." This declaration should reawaken the generous sentiments which the people of the United States have felt and manifested toward Cuba in the past. Unfortunately for both countries, through a misguided economic policy, the United States has been mainly responsible for the troubles of Cuba in recent years. After fostering the development of sugar as the chief industry, it suddenly reversed its policy, with the result that the economic life of the island was paralyzed. The United States has the power to restore prosperity to Cuba by means which will also promote the prosperity of this country and be in harmony with the policy of trade expansion with Latin America. President Roosevelt has handled our relations with Cuba through the crisis of recent months with great good judgment, including the prompt recognition of the Mendieta Government, and there is reason to be hopeful that the relations between the two countries are entering upon a new era, more intimate and mutually helpful than that of any period in the past.

Money and Banking

The money market in January has shown an easing in tone characteristic of this time of year. Money rates have shown no very important change, no doubt partly because they were already extremely low and partly because of the psychological influence of the Government's large borrowing program. Supplies of money, however, have been plentiful to the point of surfeit, as shown by the large oversubscription of the $1,000,000,000 Treasury offering on the 23rd, and by a more active demand for commercial paper and bills. Commercial paper rates were shaded slightly, a larger proportion of the better names going at 1¼ per cent than formerly. Bills held steady at ½ of 1 per cent asked for 90-day maturities, time money at ¾—1¼ for 60—90 days, and call money at 1 per cent. Little change occurred in the rate on 90-day Treasury bills, which ranged between 0.62 and 0.72 per cent.

The main source of added funds in the market was the return of approximately $270,000,000 of currency to the banks since Christmas, which replenished the cash reserves of the banks, and raised excess reserves to a new high level of around $950,000,000 for all member banks. Of this total, New York City banks on January 24 held $181,000,000 and Chicago banks $168,000,000, with the balance distributed widely throughout the country. An encouraging feature of the banking situation has been the improvement in the condition of country banks in many localities, caused in part by redeposits of currency and by the large disbursements by the Govern-

ment. No doubt the temporary deposit guarantee plan, effective January 1 on all deposits up to $2,500, has been a factor in the redeposit of currency.

The Rise of Bond Prices

The bond market has staged the most outstanding performance of all the financial markets, despite the weight of prospective new Treasury financing. Responding with vigor to the promise of greater currency stability, increased supplies of funds, and more encouraging business reports, prices advanced throughout practically all departments, with gains particularly pronounced among the second grade issues. United States Government issues tended to soften early in the month, following presentation of the budget, but later hardened with the rest of the list.

With the advances of the past month, the corporate bond market quite generally wiped out the losses of last Fall, and is back once more at the high levels of the Summer. Bonds of AAA rating reached the highest levels since before the war. Those of lesser ratings have made even greater recoveries from the low points, as indicated in the following table based on the index of Moody's Investors' Service, but have remained below the best predepression levels, which is not surprising in view of the greater sensitiveness of bonds of this class to the uncertainties remaining in the business situation:

Moody's Index of Bond Prices
120 Domestic Corporation Bonds—Computed from Yield Basis

Ratings	Jan. 1928	June 1932	April 1933	Aug. 1933	Nov. 1933	Jan. 29 1934
AAA	104.85	90.13	99.52	107.67	103.48	108.03
AA	102.30	75.71	84.85	99.68	90.97	98.41
A	97.48	59.22	73.15	88.77	79.91	89.86
BAA	90.97	43.06	55.11	73.95	63.11	75.92

The Budget

The estimates of Governmental expenditures and prospective borrowing presented by the President in his budget message to Congress, like the monetary bill, need not have occasioned surprise, as they had been foreshadowed by previous acts and policies. No secret has been made of the various relief projects undertaken by the Government or of the fact that they would cost money. In the September, 1933, issue of this Letter it was pointed out that the Government at that time had commitments which, if carried out, would involve Federal expenditures or guarantees, amounting to ten billions of dollars.

To be sure, this expenditure program was somewhat slow in getting under way. For the first three months of the current fiscal year—that is, from July 1 to September 30—the aggregate outlay, including provision for debt amortization, was 19 per cent less than in the corresponding period of last year. The deficit was less than half what it was in the same period a year ago. Unless money is to be thrown away, it takes time to plan and organize a scheme of spending involving billions. Moreover, it is possible that a greater emphasis upon other methods of recovery was also a factor in the failure to push spending more rapidly at first.

Probably this delay in getting the spending program started was a cause of the astonishment which greeted the President's message, as it doubtless had encouraged many to disbelieve that all the vast sums authorized on paper would actually be disbursed. There was basis for surprise, too, in the plan to crowd so huge a total of payments within a six-months period. The President, however, is to be commended for frankness in not attempting to minimize the costs of the recovery program, in contrast with the usual tendency of government, which is to gloss over unpalatable figures of this nature.

At all events, the President's message has thrown the question of fiscal policy into the spotlight. The program has been vigorously attacked by those who believe that it constitutes a menace to Government credit, leading eventually to inflation, and that it introduces artificialities into the situation which will impede the recovery of private enterprise. It is warmly defended by others who assert that the expenditures are necessary, not only for relief, but to "prime the pump" for recovery by putting purchasing power into circulation.

The Budget Totals

Any discussion of the budget program naturally involves, first, the aggregate totals to be collected and spent. Briefly, the President estimates that for the fiscal year ending June 30 next, the ordinary cost of running the Government, including the usual provision for amortization, will amount to $3,534,000,000. Emergency expenditures are estimated at $6,357,000,000. These, plus a supplementary sum of $1,166,000,000 not included in the budget, but which the President believes will be needed to provide adequate relief, make a total expenditure of $11,057,000,000.

Against these expenditures, taxation and other revenue are expected to bring in $3,260,000,000, leaving an aggregate deficit of $7,797,000,000. With $488,000,000 allocated to debt amortization, the net increase in the public debt for the year is estimated at $7,309,000,000. Of this increase, $1,125,000,000 occurred during the period July through December, 1933, which leaves something over $6,000,000,000 to take place during the period January through June, 1934.

For the fiscal year ending June 30, 1935, the President is more optimistic. Relying upon

an increase of 21 per cent in business, as measured by the Federal Reserve Board's index of production, he estimates that emergency expenditures can be cut to $2,723,000,000, while revenue collections are counted on to reach $3,975,000,000. Ordinary expenditures are placed at $3,763,000,000 which, in conjunction with expected revenue and other expenditures, would reduce the net deficit, including the sinking fund, for the year to $2,512,000,000.

By 1936 it is hoped that both ordinary and extraordinary expenditures will be in balance with receipts, thus ending the period of deficit financing.

On the basis of this program, the public debt at the close of the current fiscal year will stand at $29,847,000,000, a new all-time peak. With the additional borrowing expected next year, the maximum debt, according to present estimates, will be reached on June 30, 1935, at $31,834,000,000, a level $5,237,000,000 above the highest point reached just after the close of the war, and nearly double the total at the post-war low in 1930. This total does not include the contingent liability as guarantor on the $2,000,000,000 authorized bonds of the Federal Land Banks and $2,000,000,000 bonds of the Home Owners' Loan Corporation. At the present time these bonds are guaranteed as to interest payments by the United States Government and it is proposed to extend the guarantee to apply to the principal also.

Classification of Expenditures

How is the money to be spent? A partial answer to this question is afforded by the following table showing the emergency expenditures for 1934 by broad classifications. This table is exclusive of the supplementary $1,166,000,000 asked for by the President, the purposes of which were not itemized:

Emergency Expenditures — Fiscal Year 1934

(In Millions of Dollars)

Public Works Administration	$1,677
Agricultural Adjustment Administration	103
Farm Credit Administration	40
Emergency Conservation Work	342
Reconstruction Finance Corporation	3,970
Tenessee Valley Authority	19
Federal Land Banks	52
Federal Deposit Insurance Corporation	150
National Industrial Recovery Administration	4
Total	$6,357

It will be observed that the appropriation for the R.F.C. covers 62 per cent of the emergency expenditures, and that R.F.C. and public works combined account for 89 per cent of the total. The other items are self-explanatory. In view, however, of the importance assigned to the R.F.C., a breakdown of this agency's figures is desirable.

Proposed R. F. C. Expenditures for 1934

Net After Estimated Repayments

(In Millions of Dollars)

Loans to banks and trust companies	$ 280
Loans to railroads	93
Loans to mortgage loan companies	180
Loans to Federal Land Banks	171
Purchase of bank preferred stock, capital notes, etc.	1,350
Grants to States for relief purposes	462
Loans for drainage, levee and irrigation districts	50
Loans for self-liquidating construction projects	93
Loans for foreign sale of agricultural surpluses	100
Loans for domestic storage and marketing of agricultural commodities	498
Loans to joint stock land banks	81
Direct loans to farmers under Emergency Farm Mortgage Act	200
Purchase of Home Loan Bank Corporation stock	82
Purchase of Home Owners' Loan Corp. stock	199
Other expenditures	131
Total net expenditures	$3,970

Extenuating Circumstances of Current Debt Increase

It will be clear from an examination of the foregoing figures that the contemplated increase of debt will have certain extenuating features that are entitled to consideration. A substantial portion of the increase will be offset by the acquisition of assets having a recoverable value. In his budget message, the President said that the Government held collateral or other assets valued at $3,559,000,000 against outstanding advances, and it is estimated that, if the borrowing program for the next year and a half is carried through, the Treasury in 1935 will hold assets of something like $5,462,000,000 face value against a public debt of $31,834,000,000. To the extent that these assets pay out, the proceeds will reimburse the Treasury and provide for debt retirement without burden upon the taxpayer. Some of these assets unquestionably are of a high grade. The investments by the R.F.C. in the preferred stock and capital notes of banks are clearly of this class. Certain of the assets, of course, will have to be written down, but even so there should be considerable salvage value in the totals which would be increased with an improvement in business. The R.F.C. has not been known as an easy lender, at least so far as its loans to banks, railroads, insurance companies and the like are concerned. It is noteworthy that out of $2,749,000,000 loaned and disbursed by the R.F.C. from the date of its organization in February, 1932, to December 31, 1933, $1,031,000,000, or 37 per cent, has been repaid already.

Even in cases where the Government has made direct outlays, as for example for public works, the sums that are spent for useful and necessary projects should add to the wealth and productive power of the country. To the extent that the Government expenditures represent the acquisition of realizable assets or the furthering of projects having some eco-

nomic utility, the increase of debt is evidently in a different category from that which occurs during a war when capital and wealth are being destroyed.

Furthermore, Government spending now comes at a time when the activity of private industry is at low ebb. For this reason it lacks the same inflationary influence that such spending has in wartime when the demands of the Government are supplementary to those of a booming private industry. It is the competitive bidding by the Government for goods at a time when merchants and manufacturers already have all the orders they can fill that causes the inflation of prices and credit which is characteristic of government wartime borrowing and which lays the basis for the deflation that follows. Under present conditions Government spending has been tending to supplant, rather than supplement, private spending. The volume of Government indebtedness has gone up, but the volume of private indebtedness has gone down. There has been thus far no great increase in the total volume of credit and currency in use, such as would denote inflation. In fact, one of the outstanding features of the situation has been the refusal of credit to expand in spite of all the efforts to make it do so.

Rapid Expansion of National Debts Always a Serious Matter

Making every allowance for these, and possibly other, extenuating circumstances, it nevertheless remains true that any sudden and abnormal expansion of the national debt is always a serious matter. Government credit is at the basis of all credit, and in time of depression, when there is distrust of most other forms of credit, tends to become the final security against complete paralysis of the economic system. Anything, therefore, that tends to impair government credit carries with it potentialities for trouble which must be weighed carefully against any advantages that might be hoped for.

It should be remembered also that the building up of a huge national debt inevitably implies an aftermath of headache in the form of burdensome taxation. This not only exerts a repressive influence on business, but tends to promote all sorts of radical social doctrines, including theories more concerned with redistributing wealth than of raising any particular amount of revenue.

We have indicated in previous paragraphs that the increase in the national debt now in progress will have certain extenuating offsets. It would not do, however, to over-estimate the ultimate liquidating value of the collateral pledged against Treasury advances. Nor can it be assumed that public works conceived and carried out under pressure of a demand for unemployment relief will add in all cases to the real wealth of the country. It is well known that a substantial part of the money derived from public works funds and diverted to the C. W. A. will produce little of economic value, however much these expenditures may be justified from a humanitarian standpoint. Moreover, despite all possible precautions, there is bound to be a great deal of waste in any such gigantic program as this. Much money will go for undertakings which yield little or no direct return to the Treasury, and even involve a continuing drain on the Government for maintenance. During the past ten years many of our States and municipalities have learned to their sorrow that it is possible to have more schools, roads, parks, etc., than can be paid for even though the projects in themselves have had much to commend them.

The whole program is quite frankly experimental. If the revival takes place, as is hoped, relief expenditures can be decreased, Treasury loans will be repaid, and revenue collections will increase, with the result that the expanded indebtedness will not prove unmanageable. If, on the other hand, the program should fail to generate a lasting recovery the effects on Government credit might be serious enough to impede orderly financing and force a resort to fiat money.

The argument is inadmissable that because the Government spent lavishly and incurred a huge increase of debt to finance the war emergency it would be proper to follow a similar program in the present emergency. It is not merely the ability to sell bonds and incur debt, but the consequences of doing so, that have to be taken into account. The terrible economic distress that afflicts all countries today is the product largely of the enormous increase in national debts that occurred during the war, with consequent inflation everywhere. There may be valid arguments for a borrowing program, but the example of what happened during the war is not one of them.

Public Debt in Great Britain and the United States

The statement is frequently made that even at $32,000,000,000 our public debt would still be less than that which Great Britain supports (approximately $40,790,000,000 at current rates of exchange) with a much smaller population, per capita income and national wealth. From this the conclusion is drawn that the expansion of indebtedness contemplated by our Government would not be excessive. Such comparisons, however, are inaccurate and misleading. They take account only of the debts of the national governments, and ignore entirely the debts of the political sub-divisions which constitute so large a factor in the total in-

debtedness of this country. In the United States, the debts of the States and municipalities approximate $19,000,000,000, which, added to $30,000,000,000 of Federal indebtedness at the close of the current fiscal year, makes a total indebtedness of close to $50,000,000,000. In Great Britain, on the other hand, the local indebtedness is comparatively light, amounting to only about $6,865,000,000, according to the best available figures, so that the total debt load is somewhere in the neighborhood of $47,655,000,000.

These figures are not intended to prove that the burden of public indebtedness weighs as heavily in this country as it does on Great Britain. It is true that, measured against population and national wealth, our public debt is relatively lighter than that of Great Britain, even though the comparison is not as much in our favor as is sometimes claimed. However, this is an advantage which it is to our interest to preserve, and there would seem to be no good reason why this country should want to contend with Great Britain for the dubious distinction of carrying the heaviest debt load. One of the curious things about the whole monetary and debt controversy is the fact that many of the very same people who clamor at one moment for more Government spending and more Government borrowing contend in almost the same breath that the burden of debt in this country is already insuperable and requires depreciation of the currency if it is to be borne at all.

Prospects for Treasury Financing

Including $6,000,000,000 of new money and $4,000,000,000 for refunding maturities, the Treasury faces the task of finding a market for $10,000,000,000 of Government securities in the six months January through June. The job is a formidable one, but the country at large has faith in the Administration, and the recent move to define more closely the limits of currency fluctuation has tended further to restore confidence in the monetary system. Even though currency uncertainties may not be completely dissipated, there remains a large market for Government obligations with insurance companies, banks and similar investing organizations which have money to employ, but which are not permitted to purchase equities, and which have less to fear from currency depreciation than most investors by reason of the fact that their liabilities consist of contracts to repay fixed amounts of dollars.

Bank reserves continue super-abundant, and with the possibility of a large return of currency from hoarding in consequence of confidence generated by the deposit guarantee law, may become even larger. Finally, the Government itself has large resources for "making a market" for new issues, not only through use of the $2,000,000,000 equalization fund set up out of the "profits" of gold revaluation, which has been authorized to buy Government securities as well as foreign exchange, but in various other ways in which the Government is in a position to exert its influence.

The offering in January of $1,000,000,000 of short-term certificates and notes in the orthodox way, and at rates certain to be attractive to investors, was heavily oversubscribed, and indicated an auspicious beginning on the financing program.

The Test of Success

The real test of the spending program will not be in the ability of the Treasury to dispose of a given amount of securities, or even in a favorable showing for trade while the spending is in progress, but in the ability of the Government to stop spending when it wants to without bringing on a corresponding slump in business. The President has given clear evidence in his budget that the extraordinary measures proposed are directed primarily towards the emergency, and that he looks forward to the time when the business of the country will be able to go ahead once more under its own motive power. The deficit will be large this year, but in 1935 it is expected to be less, and in 1936 it is planned to have it eliminated altogether.

Whether or not the Government will be able to effect this transition from a publicly to a privately supported economy will depend a great deal upon the progress that has been made in restoring the balanced relations which are essential if people are to trade with one another. This balance was violently upset, first by the inflation and later by the fall of prices. Prices of some commodities and services fell more rapidly than others, with the result that old trading bases were destroyed and a new equilibrium has to be worked out. The efforts which the Government has been making to improve the relative position of agriculture show that the authorities are aware of this problem of price disparities. It is significant, however, that the Government is not depending upon the expenditure of money to lift the farmer out of his difficulties. Agriculture is being told plainly that far-reaching adjustments in production are imperative if lasting improvement is to be hoped for.

In a similar way, there are problems to be worked out in connection with merchandising and manufacturing which cannot be solved merely by increasing Government expenditures. The relation of costs of production to consumer purchasing power is troubling a great many business men, who are finding out that although codes may fix wages and prices, and in some degree control production costs,

there seems to be no way of making consumers buy when prices are too high for their pocketbooks.

The theory that government expenditures are needed to "prime the pump" obviously carries with it the assumption that the economic mechanism is in working order but that it lacks within itself a force sufficiently compelling to put it into operation. This explanation fails to take account of the eagerness of business men to do business whenever there is the slightest hope of making profits. The great incentive behind all business is the universal craving for the satisfaction of human wants. This is sufficient guarantee for activity if the mechanism is in adjustment.

The New Monetary Act

The proposals of President Roosevelt for the devaluation of the standard dollar and its approximate stabilization at 50 to 60 per cent of its former gold value are pursuant to the policy which has been foreshadowed since last April. Therefore, the element of surprise is absent, and inasmuch as the conflicting views upon the general policy of devaluation have been freely expressed, there is little object in carrying that discussion further. The authorities upon whom responsibility rests having reached a decision, interest now centers upon the collateral proposals, and the probable effects of the legislation.

It is proper to say that there has been no issue over the authority of the Congress to regulate the country's money. Such authority is inherent in sovereignty and our written Constitution gives it to Congress directly. However, any proposal to change the value of the money, which is the basis of all economic relations, is extraordinary and obviously it would be undesirable to have the use of this power constantly or frequently involved in political agitation. Whatever is extraordinary becomes less so every time it occurs, and even now apprehensions arise that familiarity with the idea of change may suggest another change if this one should prove disappointing in immediate results. It is to be hoped that with devaluation legally accomplished by this act the collateral policies may not create new uncertainties.

In every country, bank credit, in the form of notes or deposits, is a far more important means of payment than government currency. Indeed, in most countries currency issues are made only through duly authorized banking institutions, which in fact are agencies of the governments for their management.

The general authority of governments over the banking business is unquestioned, although, unfortunately, in this country it is divided between the national and the State governments. Thus the only question about government regulation is as to the means by which it shall be conducted. We have a highly specialized economic system, the basic principle of which is that in every line specialized knowledge and skill are much superior to inexperienced and untrained ability. This rule holds true in activities assumed by governments as well as in the learned professions. The Federal Reserve system was created by carefully considered legislation to be the agency for exercising public supervision and authority over banking, and while it has not prevented all disorder in banking under the abnormal conditions of the last twenty years, it is generally recognized to be the best organization for that purpose yet devised. Some such instrumentality obviously is necessary. Public authority means nothing without information as to how it is to be exercised.

The outstanding feature of the new bill in its relation to banking is a proposal for the transfer of the custody and management of gold reserves from the Federal Reserve system to the Treasury. The reasons for this departure and a discussion of the subject are given herewith.

The Functions of a Gold Reserve

The President's message to Congress on the new monetary measure begins with a simple and uncontroversial statement of why gold reserves are desired. In substance it is that they give stability to a monetary system by linking it up with other monetary systems likewise on a gold basis, affording a common basis for price-making and all business.

The argument for transferring the gold reserves follows certain premises, the purport of which is that gold plays no active part in domestic business, but only in international relations. The President says:

> The free circulation of gold coins is unnecessary, leads to hoarding and tends to a possible weakening of national financial structures in times of emergency. The practice of transferring gold from one individual to another or from the Government to an individual within a nation is not only unnecessary, but is in every way undesirable. The transfer of gold in bulk is essential only for the payment of international trade balances.

Practically this is up-to-date gold standard doctrine, for while there is something to be said theoretically in favor of free conversion of a domestic currency into standard money, the use of gold in common circulation is, as the President says, undesirable for a number of reasons. When the Federal Reserve system was established, the leading central banks of the world were all maintaining the policy of redeeming their currencies in gold on demand, and it would have been an anomaly for the Federal Reserve system to have established a different policy, but in resuming gold payments after the war the Bank of England and Bank of France were both relieved by law of

the obligation to pay gold in small amounts, this policy apparently being intended to obstruct withdrawals for domestic hoarding or circulation, without restricting withdrawals for the international settlements. Since that time other central banks have imposed similar restrictions, and there is general recognition that extraordinary conditions sometimes occur under which restrictions may be advisable and necessary.

It is pertinent to point out that this paragraph is fully in accord with the gold standard theory that domestic currencies, including the deposit and check system and the bank clearings, afford practically unlimited facilities for domestic payments. Purely domestic business is not in any real sense a charge on the gold reserves and has not been under the Federal Reserve system.

The suspension of gold payments was not caused by lack of gold to serve the normal uses, but by an extraordinary demand for hoarding at home and also for transfer to Europe, which in fact was another form of hoarding. The primary cause was fear that a change in the monetary system was impending. It was an emergency which could not have developed from normal business conditions. It was the culmination of the economic disorganization caused by the war.

This experience may be taken as illustrating the President's argument for having all the country's monetary gold concentrated in the United States Treasury under full government control. Hereafter there can be no lawful ownership elsewhere, except for specific purposes and under Treasury regulations. On account of its importance we quote the President's description of the procedure of taking over the holdings of the Reserve banks.

The gold is purchased by the Treasury issuing therefor gold certificates, which, to quote the President, will be

> secured at all times dollar for dollar by gold in the Treasury—gold for each dollar of such weight and fineness as may be established from time to time.

The President continues as follows:

> Such legislation places the right, title and ownership to our gold reserves in the Government itself; it makes clear the Government's ownership of any added dollar value of the country's stock of gold which would result from any decrease of the gold content of the dollar which may be made in the public interest. It would also, of course, with equal justice, cast upon the Government the loss of such dollar value if the public interest in the future should require an increase in the amount of gold designated as a dollar.
>
> The title to all gold being in the Government, the total stock will serve as a permanent and fixed metallic reserve which will change in amount only so far as necessary for the settlement of international balances or may be required by a future agreement among the nations of the world for a redistribution of the world's stock of monetary gold.

Taking Over the Gold Reserves

It has been argued that in taking over the gold reserves before the devaluation becomes effective any question as to the ownership of the gain or "profit" is avoided. The act of reducing the weight of gold in the unit obviously will increase the number of units, or dollars, in the existing reserves, and every one of the new dollars will pay any debt or discharge any obligation as completely as one of the former-weight dollars. If the devaluation occurred with the gold in the Reserve banks this benefit would nominally inure to those banks, which are private corporations, nominally owned by the member banks. This situation, however, is qualified by the fact that under the Reserve act the member banks never can claim more than 6 per cent cumulative dividends on their stock, and in case of liquidation the face value of their stock. Therefore, the question of whether the member banks might claim a share of the "windfall" was hardly a practical one.

The French monetary unit was devalued by about four-fifths, and the Government took the gain on the gold stock held by the Bank of France, but did not take over the gold itself. It is not clear that any change in the status of the Reserve system was necessary either to the policy of devaluation or to effective public control of the gold reserves.

Effects of the Act Upon the Reserve System

The Reserve system is a part of the Government, established to perform functions of a highly specialized character. The Secretary of the Treasury is a part of the political machinery of the Government, a member of the Cabinet, and as such identified with the political and partisan administration. He may be a trained financier and economist, but that has not been usually the case. He is a temporary public official. There have been three Secretaries of the Treasury in the last year. On the other hand, the Reserve Board consists of eight members, including the Secretary of the Treasury and Comptroller of the Currency, ex-officio, all appointed by the President, and the six special appointees serve for terms of ten years. These considerations evidently relate to the general principle of governmental organization and not to present officials. The question involved is over the consolidation of power in the political and partisan executives, as against the development of responsibility in the expert services which governments are more and more establishing. Would it be desirable to turn over the functions of the Interstate Commerce Commission to the Secretary of the Treasury? All branches of the Government whose heads are appointed by the President are a part of the executive organization, and the President has the authority to coordinate their activities, but surely expert services are to be desired and a degree of responsibility must attach to officials who head them.

To some readers these comments may seem to take an unwarranted range, but with approximately $4,000,000,000 of new gold holdings and the assignment of certain new functions, the Treasury is equipped with a cash reserve and an authority ample for running an important central bank entirely independent of the Reserve system. The Thomas amendment to the Farm Act of last Spring gives authority for an issue of currency larger than that of the twelve Reserve banks combined and the new act carries authority for the Treasury to set up from its free gold a fund of $2,000,000,000, to be at the command of the Secretary "for such purchases and sales of gold, foreign exchange, and Government securities as the regulation of the currency, the maintenance of the credit of the Government and the general welfare of the United States may require."

These provisions are not in themselves novel or extraordinary at this time. The proposed fund is similar to the equalization fund approximately as large which Great Britain has been operating for nearly two years for the stabilization of its currency, but the Chancellor of the Exchequer in announcing the establishment of this fund in the Treasury stated that it would be operated through the agency of the Bank of England. Operations to stabilize the price of government securities are probably not unusual, although seldom provided for in this manner. The extraordinary thing is that such functions usually are confided to the Central banks and are in the regular line of Reserve system functions in the management of the currency and as fiscal agent of the United States Government. The system was created for such purposes, has the necessary organization and would seem to be the natural agency, which, of course, stimulates speculation as to why it is not used. The Treasury will have to organize for such activities. It is true that the determination of policies in such matters belongs ultimately to the President, but he should have the best counsel available, and the agency and methods of execution are of great importance. It is quite conceivable that two agencies conducting open market operations might come into conflict, and if this should mean that the Federal Reserve system was no longer to be a factor in the regulation of the currency a decided innovation in currency control would be introduced. It is through the public demands on the banking system that currency regulation is most effectually guided.

The provision of the bill for supplying gold for the international balances illustrates this ambiguity. It reads:

> Section 3. The Secretary of the Treasury shall, by regulations issued thereunder, with the approval of the President, prescribe the conditions under which gold may be acquired and held, transported, melted or treated, imported, exported or earmarked: (a) for industrial, professional and artistic uses; (b) by the Federal Reserve Banks for the purpose of settling international balances; and (c) for such other purposes as in his judgment are not inconsistent with the purpose of this act.

The provision of gold for the settlement of international balances is a highly important matter, directly related to banking. Upon what basis, or upon whose judgment, shall the wants be supplied?

The general purport of the plan and official explanations of it have been that the Reserve shall maintain its past functions with practically no change except that its reserves in the future will consist of Treasury gold certificates backed by equal holdings of gold. Our comments are based upon the assumption that this is the objective in the President's mind, but the plan has proposed certain permanent changes in the Government, and it is in order to consider all of the possibilities that exist in them. Obviously the Treasury, even with all the new powers proposed or latent in this measure, could not take the place of the Reserve system with its twelve regional banks in supervising and serving the multiplied units of the country's banking system. The point raised is that the foreign exchanges are vitally related to domestic banking (and all business) and that there cannot safely be two authorities over the exchanges.

Owen D. Young's Views

Since the foregoing was written Mr. Owen D. Young has appeared before the Senate Committee on Banking and Currency, at its invitation, and given his testimony regarding the bill. Mr. Young is a citizen of personal distinction, but special interest attaches to his views in this instance because he has been a member of the Board of Directors of the Federal Reserve Bank of New York since 1921, and at present is serving as one of the three members appointed by the Federal Reserve Board at Washington to represent the United States Government, as provided by the Federal Reserve Act. Replying to inquiries, Mr. Young expressed concern as to the effects of the measure upon the Federal Reserve system. His opinion is concisely stated in two paragraphs which we quote, with regret that we have not space to quote the questions and replies following. He said:

> When the influence over the credit volume of the country passes from the Federal Reserve System to the Treasury, then the Federal Reserve System is practically abolished. It still remains only, if retained at all, as an administrative agency of the Treasury.
>
> That is the reason why I think that you will have to be very careful with this bill lest you destroy the Federal Reserve System, perhaps unintentionally. Of course, so long as the Federal Reserve System functions you will have two forces operating in the market.

Following Mr. Young's testimony the Senate Committee voted to amend the bill as

it had passed the House by limiting the duration of the Stabilization Fund to three years, and providing that it should be under the control of a new Board of five members, consisting of the Secretary of the Treasury, the Comptroller of the Currency, the Governor of the Federal Reserve Board and two others to be appointed by the President and confirmed by the Senate. These amendments, proposed by Senator Glass, a former Secretary of the Treasury, were adopted in the Committee by a vote of 12 to 5.

Spokesmen for the President promptly announced that the first provision would be accepted but not the second, and the Senate so voted. In this connection the President reaffirmed his previous assurance that there was no intention to set up a central bank in the Treasury, or detract from the importance of the Reserve system.

Gold Remains the Standard

Under the bill, gold is retained as the standard of value, which is a fact of great importance, and the President in his message manifests his desire for international cooperation in monetary policy. He expresses the hope that "events are leading to some future form of general agreement;" also that the pending legislation "will contribute to a world solution." In one of the quotations given above he even mentions the possibility of future arrangements for a redistribution of gold stocks. These expressions encourage the belief that aside from the difference of opinion over the necessity for devaluation to raise prices there is no serious disagreement. A common standard of value for all monetary systems is the factor of first importance in the money question. Without it confusion must exist, trade will be obstructed and there will be constant danger of competitive strife of a most demoralizing kind.

The President indicates a belief that, although the time is not ripe for complete stabilization, the fluctuations of the dollar may be held within a range of 10 per cent and that this assurance will be helpful to business. Unquestionably so, but without doubting the intent of the proposal, the probability of success must be judged by the provisions of the measure, and these are discussed in some detail further on. The President also says: "In view of the world uncertainties I do not believe it desirable in the public interest that an exact value be now fixed." It is true also that until he is clear about public sentiment and the final attitude of Congress it is prudent to avoid a final commitment.

Apparently, in this discussion of stabilization he is referring to the relation of our currency to gold and through gold to other monetary systems. This is the objective of gold standard advocates. There is but one reference in the message to stability in terms of commodities, and this is in language which any gold standard advocates might use, as follows:

> Our national currency must be maintained as a sound currency which, in so far as possible, will have a fairly constant standard of purchasing power and be adequate for the purposes of daily use and the establishment of credit.

Fluctuations in the general price level in terms of gold never have been violent except under abnormal conditions, affecting world wide demands for commodities. Free from war disturbances, gold has met the stated requirements. The Secretary of the Treasury has interpreted the proposed stabilization within the range of 10 per cent to relate to gold and foreign exchange rates, and not to any system of index price numbers. The "commodity dollar" apparently is dropped.

The Stabilization Fund

The policy outlined, to restrict the fluctuations of the dollar in the gold standard exchanges to within 50 to 60 per cent of its former parity, necessitates the exercise of planned control, and means therefore must be provided. The fluctuations in the relations of the different currencies to each other in the absence of a common standard are caused by fluctuations in trade and in day to day demands for means of payment between the countries. They are an embarrassment to international business, and by affecting the prices of products which move in international trade may affect all business. Exchange rates become a subject of speculation, which at times becomes the dominant influence. Hence the policy of attempting to smooth out the fluctuations by opportune buying and selling, supported by a fund supplied by the national treasury.

Out of the gain to the United States Treasury resulting from the revaluation of the gold taken from the Reserve banks a Fund of $2,000,000,000 is created to be known as the "Stabilization Fund," the same to be "under the exclusive control of the Secretary of the Treasury, whose decisions shall be final and not be subject to review by any other officer of the United States." The Fund shall be managed under the authority of the Secretary "and in his discretion for any purpose in connection with carrying out the provisions of this section." (10), Paragraph (a) reads as follows:

> Section 10 (a)—For the purpose of stabilizing the exchange value of the dollar, the Secretary of the Treasury is authorized, directly or through any agency or agencies that he may designate, to purchase, sell, discount or negotiate, or to contract to purchase, sell, discount or negotiate, at home or abroad, with or without endorsement or guarantee, drafts, checks, bills of exchange, acceptances, including bankers' acceptances, coin, bullion, cable transfers, foreign exchange, bonds, notes, evidences of indebtedness, including the obligations of the United States or of

any foreign government, and any obligations or securities in whatever currency payable, to establish credits therefor and generally to exercise such powers as are incidental to the powers conferred by this section.

Paragraph (b) of the same section authorizes—

the investment and reinvestment in direct obligations of the United States of any portions of the Fund which the Secretary of the Treasury, with the approval of the President, may from time to time determine are not currently required for stabilizing the exchange value of the dollar. The proceeds of all sales and investments and all earnings and interest accruing under the operations of this section shall be paid into the Fund and shall be available for the purposes of the Fund.

This extends authority for the use of the Fund to stabilization of the market value of outstanding Government obligations.

The authority given to the Secretary as stated above, is additional to the provisions of sections 8 and 9 which confirm and enlarge the authority heretofore given for the purchase and sale of gold. The language of Section 8 authorizes that official to

purchase gold in any amounts, at home or abroad, with any direct obligations, coin or currency of the United States, authorized by law, or with any funds in the Treasury not otherwise appropriated, at such rates and upon such terms and conditions as he may deem most advantageous to the public interest.

Section 9 gives similar authority "to sell gold, with authority to anticipate the payment of interest on the public debt for a period not exceeding one year."

All of these provisions are sweeping in terms, and under the circumstances there is nothing to be said of them but that everything depends upon the management of these powers. The Stabilization Fund can serve a good purpose, but its use calls for the wisest discretion. An attempt by any country to regulate the relations between its own currency and the currency of another country obviously affects the interests of the other country as directly as its own, and is easily provocative of retaliation. This has been seen in some of the comments made in this country upon the British equalization fund and now in British comments upon our action for such a fund. There is need for clear understanding that competitive strife in the use of such agencies would be mutually disastrous. It would complete the state of chaos. There is no justification for exchange manipulation as a competitive device. The only rational use, as the name given to the fund by the President implies, is for stabilization, i.e., to smooth out the natural fluctuations so far as possible, in the interest of honest, mutually-beneficial trade.

Furthermore, any attempt to fix and maintain an artificial rate of exchange is subject to dangers quite apart from the resentment and retaliation that may be incited. It is a venture in violation of economic law, and inevitably subject to the penalties of that law. The economic rate of exchange is that at which trade can be carried on and all kinds of payments brought into balance, and no country can gain any lasting advantage from any other rate.

The same may be said of attempts to "support the public credit" by buying Government securities in the market. Skillful buying and selling can smooth out the fluctuations, and help sustain confidence, but in the long run the law of supply and demand will rule in Government securities as elsewhere. In other words, the public attitude as determined by the prospects for balancing the budget will finally rule. It would be easy for the Treasury to misjudge the level at which by its own buying it could sustain its issues. Certainly it cannot for very long under existing conditions buy more than it sells.

The authorization to purchase gold on a great scale may be thought of as something desirable to hold in reserve, but in view of the proportion of the world stock which this country now holds additions thereto are undesirable, as obstructing world recovery. It cannot be too strongly emphasized that it is in the common interest to restore stability and the normal equilibrium throughout world relations—in industry, trade, prices, the monetary exchanges and all. This requires that the nations shall have their due proportions of gold as the basis of their credit systems and their exchanges. The President recognizes these mutual interests in the above reference to the possibility that this country may participate in a voluntary redistribution of gold. If this power to buy gold is intended to be held in reserve as means of defence, it must be considered that preparations for defence suggest war, and that in war all parties claim to be acting on the defensive. United States Government purchases of gold abroad have aggregated $117,000,000 since they began three months ago and all of it was more needed abroad than in this country.

It is known that a large sum in the aggregate, possibly more than $1,000,000,000, of American capital has been transferred to Great Britain and Europe in the last year to escape devaluation. In view of the undertaking to stabilize the dollar at 50 to 60 cents and the rising price possibilities, the owners of this capital may want to bring it home, and foreign capital may come also, to share in the prospective gains. Such a movement will test the ability of the Government to keep the dollar rate from rising above 60. This can be done only by giving dollars freely in exchange for the foreign currencies (sterling, francs, guilders, etc.) as they are offered, and probably a substantial part of the Fund will be so engaged. Unless it can be converted into gold and the gold brought to this country—a policy subject to foreign embargoes and undesirable

for reasons already given—the only way by which the investment in these foreign currencies can be recovered will be by selling them for dollar exchange as opportunities may occur. This means a reversal of the purchases, and will require either exports of capital from the United States or such a turnover of the merchandise trade as will create a balance of payments against this country. Such are the problems incidental to the management of currencies and exchanges which are without a common base or fixed parities.

Effects of Devaluation on Commodity Prices

The motive for devaluation is desire to raise the price-level, and there is no disagreement over the desirability of that. The policy is based on the general principle that there is a relationship between the volume of money and prices, which nobody disputes. There is an equation in which the volume of money, the volume of trade and the price-level are all factors, but there are still other factors, and they account for the different opinions upon devaluation. The idea that there is some telepathic or other mystical connection between the price of gold as fixed in government purchases and the general commodity price-level has been tested in recent months without satisfactory results. What will be the results of devaluation?

A brief answer is that as the increased supply of "dollars" made available by reducing the gold unit actually comes into use, either by direct expenditure in business activities or through still more important use as the basis of currency and bank credit, the price-level undoubtedly will rise, but in no other way can it become effective, always excepting the possible speculative effect, i.e., the effect of belief that more business is going to be done. In the long run nothing affects prices but supply and demand—the volume of production and the movement of products off the markets into consumption. The devaluation and transfer of the gold to the Treasury have no direct bearing upon business.

Approximately one-half of the new supply of "dollars" is to be placed in the "Stabilization Fund" where it is expected to serve a useful purpose, but it will not be expended in the commodity markets or for labor. The payment of the remainder upon the public debt would improve the Government's financial position, but there is no reason to think that it would directly increase business activity. If the Treasury should deposit gold certificates in the Reserve banks, thereby increasing the banking capacity to grant credit, and this credit should be expended upon public works, it would be effective upon employment, but Secretary Morgenthau has indicated that the Government has no plan for so doing at this time. Apparently it is disposed to be cautious about making devaluation effective, which is commendable.

Obviously the real situation as yet has undergone no change. The secret of bad business and falling prices for three years has been that the *will* to use money for business expansion has been lacking. Normally about 90 per cent of the business of the country is handled by the turnover of bank deposits, instead of by money payments, and the turnover in these three years has been far below normal. An increase of idle bank deposits cannot be effective upon prices. Any increase will be practically idle until the present supply has found employment.

The Foreign Exchanges

What impetus is likely to come through a further decline of the dollar in the foreign exchanges? No very important decline remains to be effected. The dollar is rating at about 62 cents in the gold exchanges and the plan contemplates its reduction to 50-60.

In time, economic forces may be expected to accomplish a complete readjustment of prices on the new basis, but economic forces are very much hampered in their influence by the new conditions with which they have to contend. Nobody wants to yield to economic forces nowadays. Everybody, every economic group, instead of recognizing any obligation to conform to economic forces, is wanting to baffle them, control them, and make its own code, often with little knowledge of the effect of such efforts upon the general situation. Under these conditions price readjustments take place very slowly, and readjustments must occur to an extent that will restore normal price relations between the different industrial groups before consumption can increase to absorb the surplus and create a normal state of employment. When that occurs, there will be a chance to get the new supplies of dollars into use and they will have their natural effect upon prices.

The depreciation of our money in the foreign exchanges unquestionably exerts an influence for rising prices in terms of our money, affecting both import and export commodities. However, although foreign trade normally has been an important factor in our domestic price situation, it has been so because it took a substantial proportion of our products off the home market. Of late years these sales have declined and the pressure of supplies in our markets has broken down prices. Lower exchange rates on the dollar enable foreigners to buy our products at lower cost in their money, which would naturally encourage them to buy more, but unfortunately other countries are unwilling to increase their importations from the United States, and are resorting to

various means of preventing it. Hence our exports are not increasing as might be expected, the pressure of supplies is not relieved and the natural influence of falling exchange rates is much lessened. The price of wheat has been influenced far more by the reduction of the last crop and the poor prospect for the next one than by the lower exchange rates. The prices of pork products, hogs, cattle and dairy products have not been noticeably affected by exchange rates. Secretary Wallace is placing little dependence upon exchange rates or devaluation in his plans for raising the prices of farm products. His addresses will readily show that his emphasis is elsewhere.

To sum up, it is not the fact that the dollar has been reduced in weight which is to produce the results, but that more dollars have been created and may be used as purchasing power for actual employment in business, disbursement in wages, for materials, etc. If they can be put into employment, prices unquestionably will rise. Why doubt that they will enter into use? Mr. Owen D. Young, in his testimony to which reference has been made above, gave a concise answer to this question. He said:

> At the moment there is a great desire on the part of all for an expansion in the use of our currency and credit. That has led many to think that the enlargement of the volume of currency and credit would expand its use.
>
> Our experience in the past year does not justify such an assumption. The Federal Reserve has increased the excess reserves of the country to over nine hundred million dollars, giving a base for eight or nine billions of additional credit; but that credit has lain dormant.

Why has that credit lain dormant? Mr. Young was not asked that question and did not volunteer a reply. The Secretary of Agriculture is writing much upon this subject and the substance of it is that under the stimulus of the war and by the application of modern technique in agriculture and to the production of other primary products, supplies of these commodities have been largely increased outside of Europe, while the European importing countries, which formerly were the chief markets where such products were exchanged for manufactures, have been seeking to make themselves more nearly self-sustaining in these goods, with the result that there has been heaping up "a worldwide over-supply." He says: "The reduced prices which resulted from these increased stocks has had a serious effect on farm purchasing power the world over."

The Secretary is striving to raise farm purchasing power over other products to the parity that existed in the pre-war years, urging that this is just as important to the other industries as to the farmers themselves. This argument for balanced farm relations applies to all unbalanced relations, for, after all the arguments about money are heard, the fact remains that everybody's purchasing power originates in the services or products that he has for sale. It is only through these that he can come into possession of money, and when price-relations in general are thrown into confusion a large part of the population is bereft of purchasing power. This is the most adequate explanation of the failure of business to use the purchasing power that has been lying idle in the banking system.

The Danger of Inflation

There remains to be mentioned the danger of inflation. If the theory is right that the principal cause of the depression has been derangements in production and trade, it follows that, whenever and by whatever combination of means and circumstances, balanced relations shall be generally restored, the depression will end and business revive. This view is broadly the basis of the activities of President Roosevelt's administration. Secretary Hull urges it strongly in his international addresses. Secretary Wallace makes it the basis of the A.A.A. policies, and the fundamental basis of the National Recovery Act is that in so great a state of confusion the authority of the Government is necessary to the restoration of orderly relations.

This reasoning leads inevitably to the conclusion that with order restored and trade flowing in normal volume, the eight to nine billions of idle credit which have been available in the banking system will come into use, and probably the release of this amount of purchasing power will be of itself sufficient to restore the price-level of 1926, which is the goal of the devaluation plan. If so, the devaluation elixir will all be available to carry the movement farther. Therein is the danger of inflation. The latent resources to carry the price-level to the 1929 mark or higher have been in the banking system all of the time, but the public has not been in a state of mind to use them. When trade revival comes and confidence is actually restored, the aggregate of all bank credit available to the public will be far beyond what is needed to carry the price-level to the 1926 stage. When it is considered that inflation was the main cause of the depression-calamity in all its magnitude, the gravity of this danger will be appreciated.

It was the rising prices, year after year, which caused the reckless speculation on borrowed money in farming lands, city real estate and stocks, creating the debts that are now making trouble. Since a similar cause always has produced a like result, there is no reason to doubt that another period of rising prices will do so.

Against this danger the opponents of inflation have sounded an alarm from the beginning. Mr. Young sounded it in his testimony before the Senate Committee. Following the

quotation from him given above, he went on to say:

> Under such circumstances you will say: "Why fear an increase of banks' reserves of three or four billion more?" My answer is that if there were any way of securing adequate contraction and control when such vast funds begin to be used, I would not fear it, but the difficulty is in the control.

In a preceding quotation Mr. Young refers to the increase in excess reserves of member banks in the past year to $900,000,000 as providing a base for an increase of $8,000,000,000 or $9,000,000,000 in the volume of bank credit, a rate of approximately $10 of member bank credit to each $1 of increased reserves. Professor Rogers, one of the President's advisers, speaking for the bill, said upon this point:

> However, the secondary inflationary effect of the use of such funds, because potentially much larger, is correspondingly more far-reaching. Once paid out, these new funds, whatever their form—whether new notes, gold certificates or simply a government deposit in the Federal Reserve banks—flow to the reserves of the commercial banks. Here they provide the base for a loan and deposit expansion of four to ten times their own magnitude. In a word, they swell the lending capacity of our banking system just as would a like expansion of Federal Reserve credit.

Senator Borah, advocating an amendment to the pending bill, making mandatory an issue of Government currency directly against the new gold profit, and calculating the part available at only $2,000,000,000 (after deducting the Stabilization Fund) said that $6,000,000,000 of currency could be issued. This idea of forcing money into hand-to-hand circulation is based on the theory that nothing but lawful money circulates, which the average bank depositor can refute by reference to a monthly statement of his own bank account. The people of this country do not carry money in their pockets to make their chief payments. They put money in banks, draw money as they want it, but make the great bulk of their payments in an informal currency, to-wit, bank checks, or circulating deposits. The proposed $6,000,000,000 of new Government currency would quickly find its way into the commercial banks as deposits, and would effect a like increase in the banking reserves, thus becoming the basis of more bank credit, as described by Mr. Young and Professor Rogers. On Mr. Young's estimate of 10 to 1, the increase of bank credit from this source would be about $60,000,000,000, on Professor Rogers' estimate anywhere from $24,000,000,000 to $60,000,000,000, and all would be additional to present resources of the banking system approximately as large as in the boom period 1925-29. As a matter of fact, during the period 1923-29, when reserves were rapidly increasing, bank credit increased constantly at more than the rate of 10 to 1.

Moreover, the $60,000,000,000 increase is not the limit. To whatever extent the $2,000,000,000 of "profit" assigned to the Stabilization Fund shall be used for the purchase of United States Government securities, or of gold for importation, a similar addition to the base for bank credit will be provided. Any use of the Fund which will facilitate transfers of capital from abroad to this country will contribute to inflation.

Means of Control

There are certain means by which credit can be withdrawn from the markets. The Federal Reserve banks can use the discount rate when the member banks again reach the borrowing stage, and the former have large holdings of Government bonds which they can feed out to the market, thereby absorbing purchasing power. The R. F. C. can wind up its affairs, collecting its loans and retiring the credits, and the withdrawal of the Government from its other extraordinary activities would have a restraining influence, but this policy is one calling for exceptional qualities of courage and judgment. The attitude of the public toward the mild efforts of the Reserve authorities to check expansion in 1919-20 and in 1927-29 is easily recalled. The public never is ready to have the turn called upon rising prices.

While much depends upon the wisdom with which the available means of control are applied, and particularly upon the stages at which they are applied, it is important to appreciate that at the utmost these means afford no assurance of being adequate if the entire new supply of bank credit, together with the idle supply, should come rapidly into use. Professor Rogers frankly so stated in his testimony before the Senate Committee. Therefore, it will be the part of wisdom to exercise great caution from the beginning, and so far as the plans of the Administration are disclosed this seems to be the policy, as seen in the attitude toward the Borah proposal and more silver legislation. Logically, however, this means that present supplies of money and credit are ample until recovery is well under way.

It must be borne in mind that the cupboard has not been bare. Those eight to nine billions of potential credit have been lying there, as Mr. Young says, for the past year, the public declining to use them. In so far as knowledge of the new supplies in reserve may exert a stimulating influence, that influence is available now. In so far as the restoration of order in industry may be necessary, that should have first attention. But it is easier to control the forces of inflation before they are released than afterward.

For this reason alone, the President does well to postpone any further action upon silver. Already he has provided for the purchase of the entire American production, and any further commitment might have results very difficult to control.

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